International Insights: Major Pension Reform Considerations

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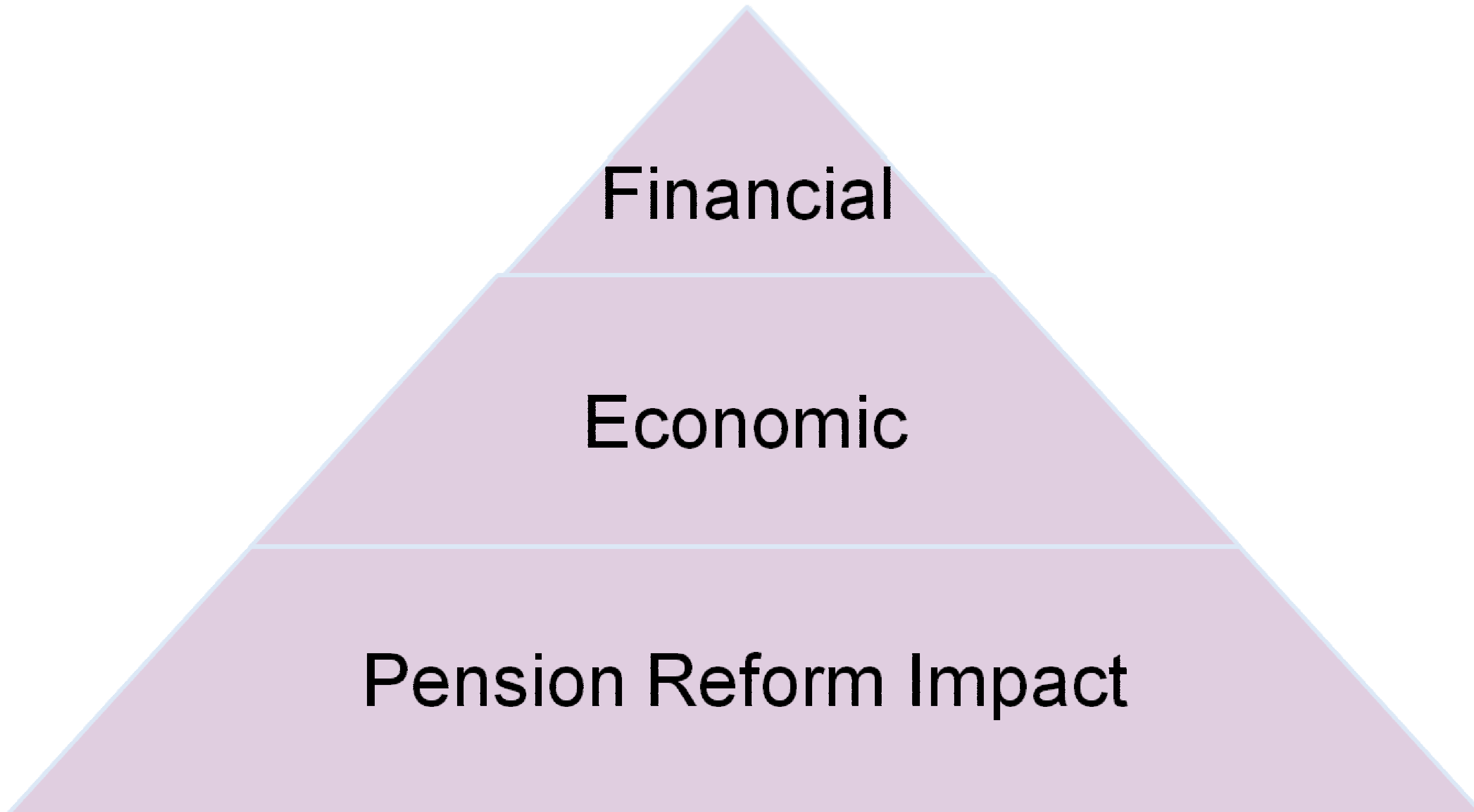
Acknowledgement - Presentation draws on OECD Research and Presentations - ‘Pensions at a Glance’ – Edward Whitehouse

Pension Reform – Period of Uncertainty



Employer and Employee Challenges

- Sharp increase in DB to DC transition
- ‘Democratization of Risk’ for the plan or scheme members
- Breakdown of paternalistic employer tendencies
  - Economic survival
- Who pays for the transition and employee benefits in the future
- Role of government – political risk
- Default fund structures
- Member engagement – can we make plan members CIOs

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Psychological Barriers & Behavioural Economics

A relatively new branch of economics that incorporates psychology

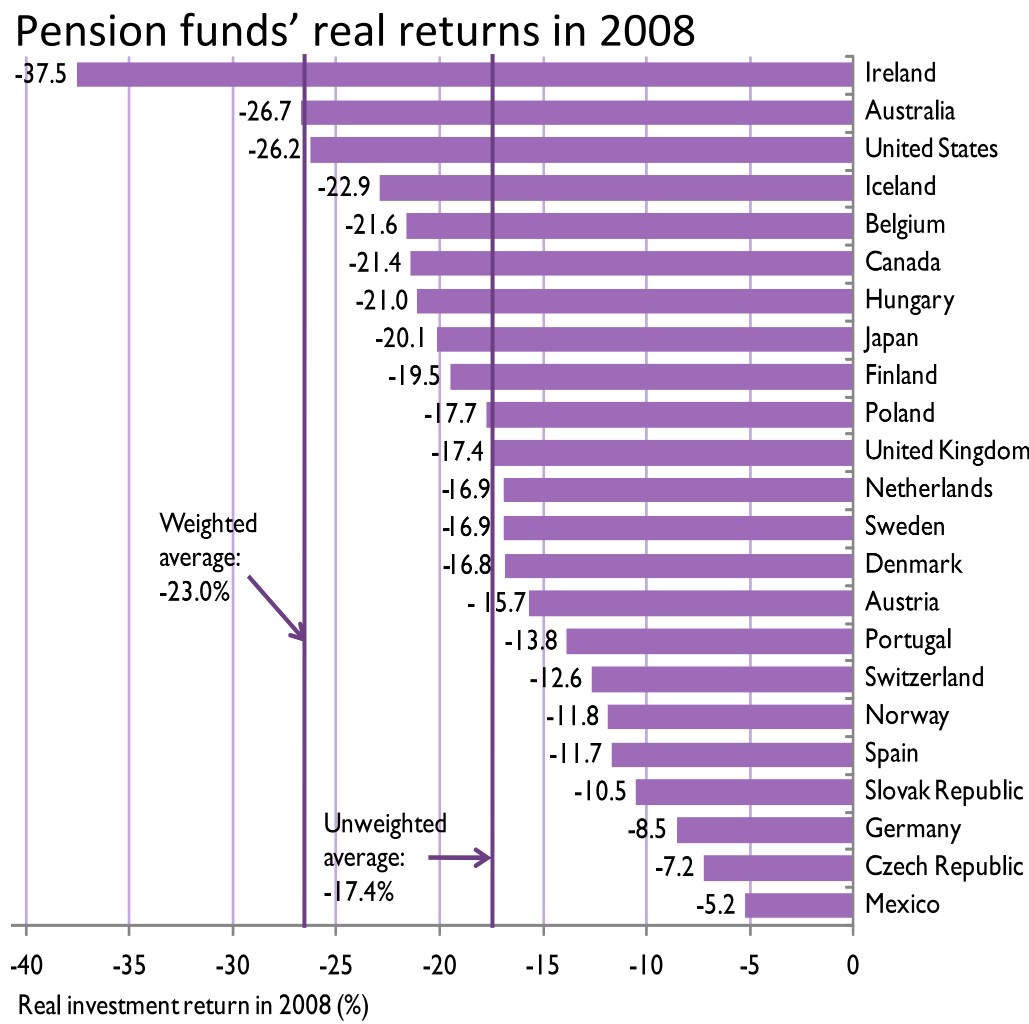
It accepts that consumers are irrational in their decision making: they do not always make choices that are in their own best interest

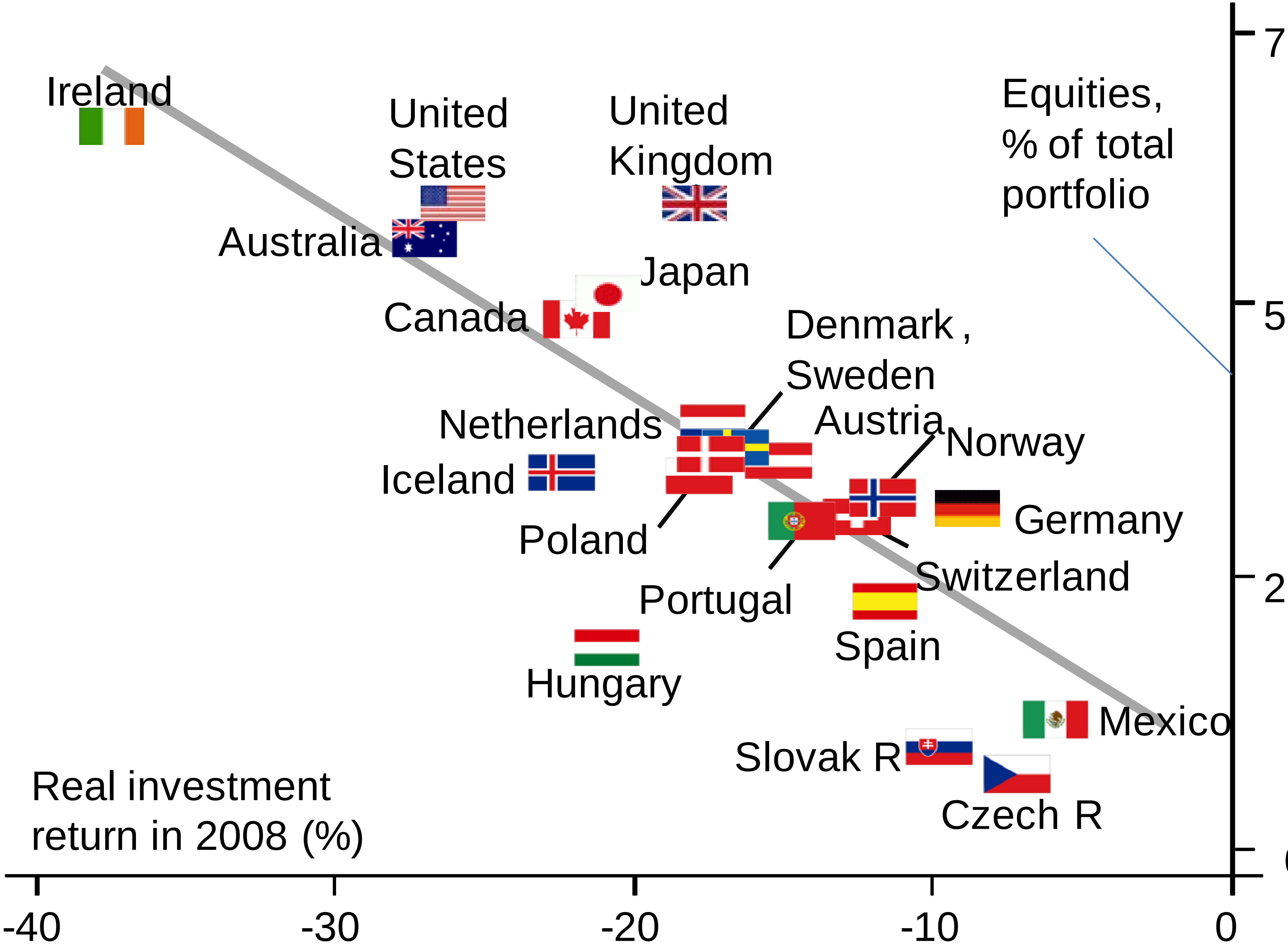
Psychological barriers to good decision making affect everyone – even sophisticated investors...

Example: In the late 1990s a client's scheme had a high proportion of members investing in the Japanese Smaller Companies Fund which was performing very badly. The client found that its own Japanese Equity Desk was leading colleagues into the fund on the basis that they were investing in what they knew. These were sophisticated investors making irrational choices about their own pensions.

It started as a financial crisis.

This had a direct effect on people's private pensions and other retirement savings

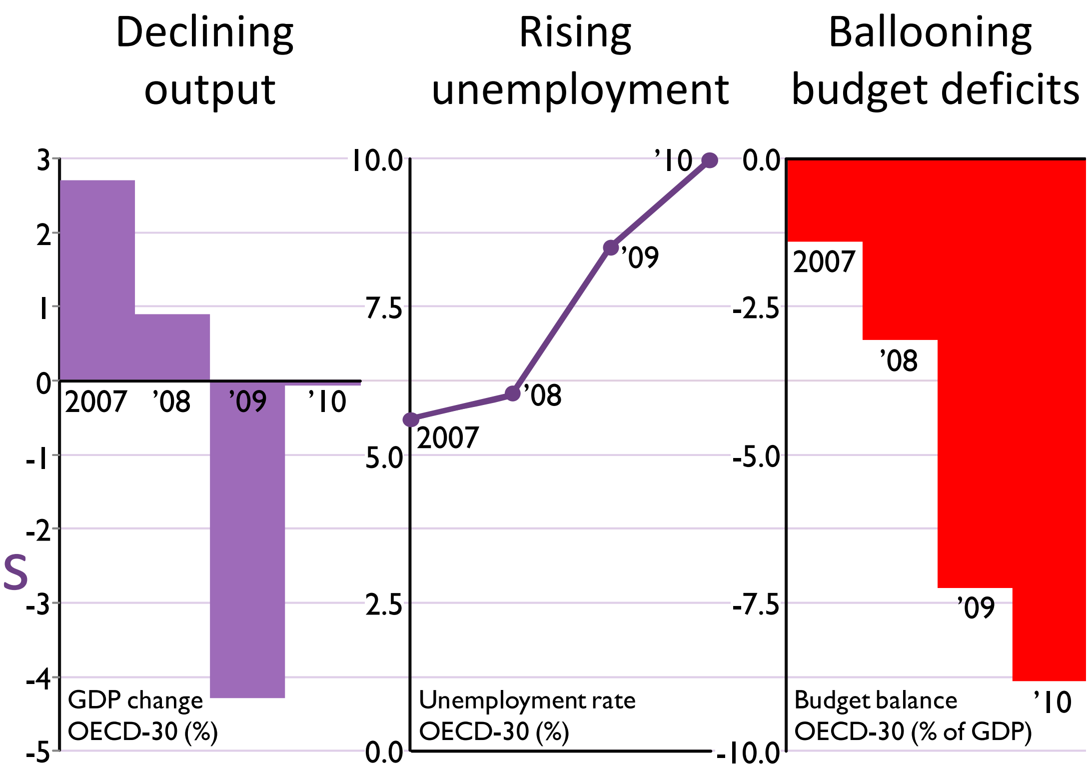


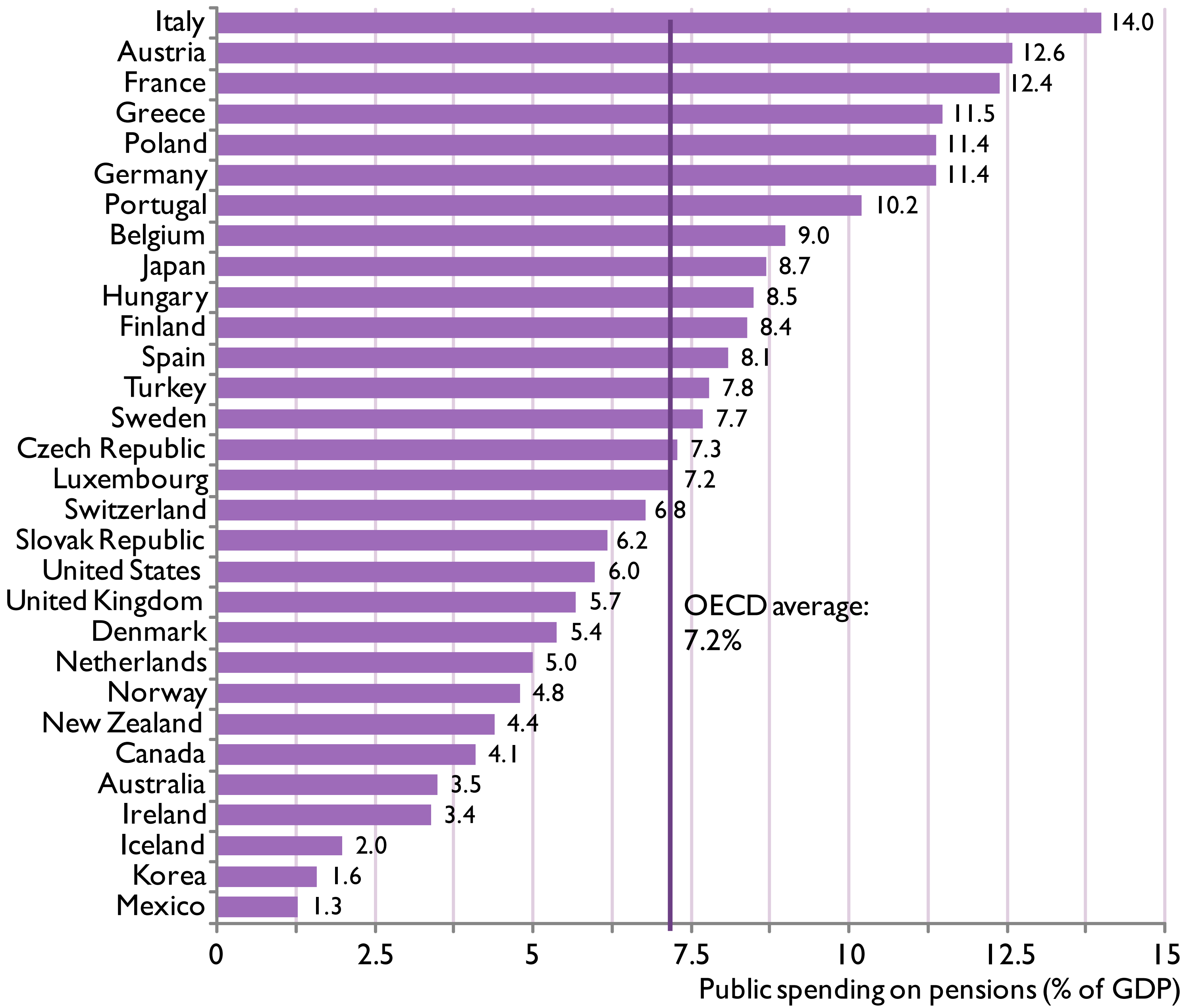


Ireland
United States
United Kingdom
Equities, % of total portfolio
Australia
Japan
Canada
Denmark , Sweden
Netherlands
Austria
Norway
Iceland
Germany
Poland
Switzerland
Portugal
Spain
Hungary
Mexico
Slovak R
Czech R
Real investment return in 2008 (%)
75
50
25
0
-40
-30
-20
-10
0

But it became an economic crisis.

Higher unemployment and pressure on wages cuts revenues from taxes and contributions

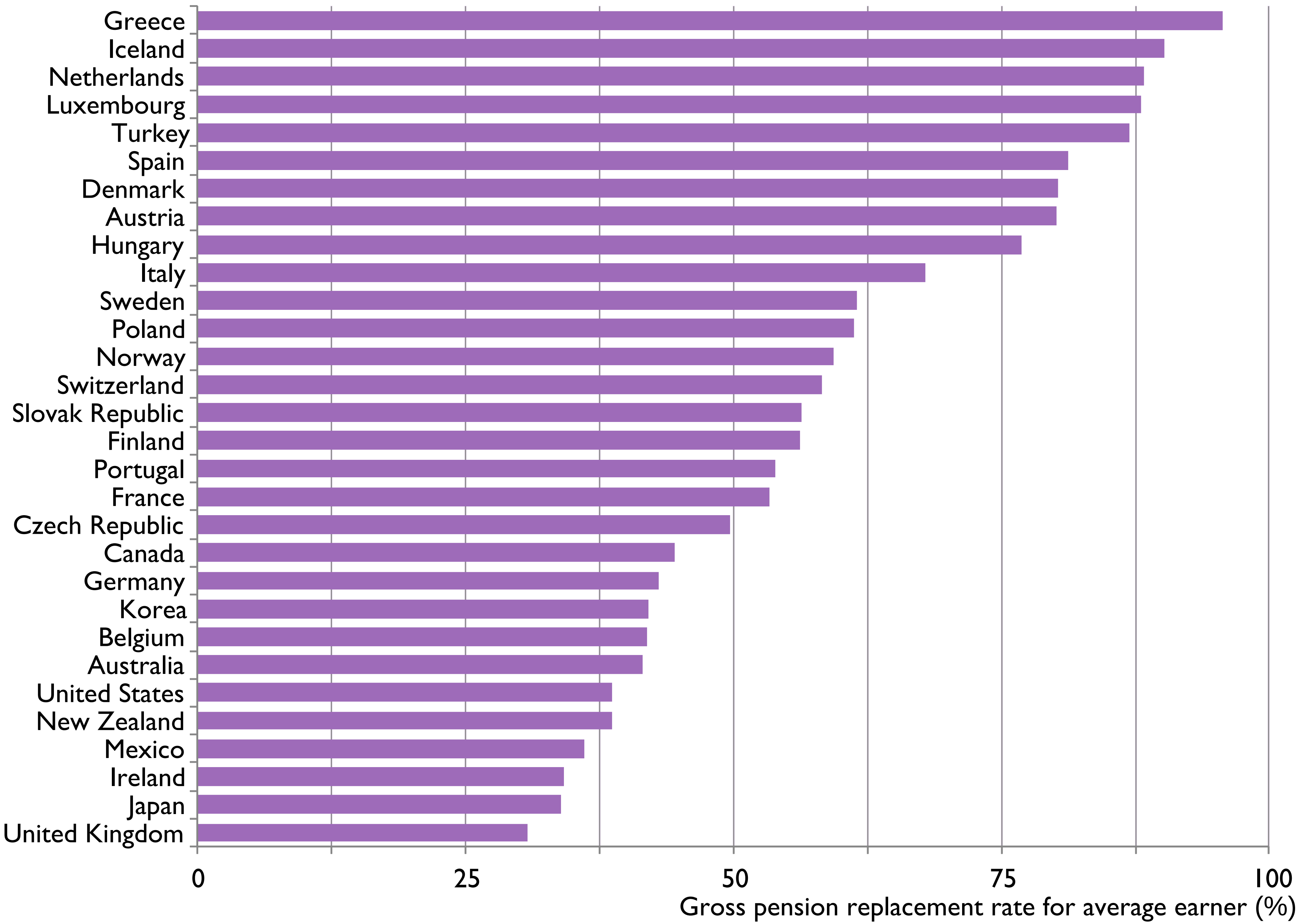


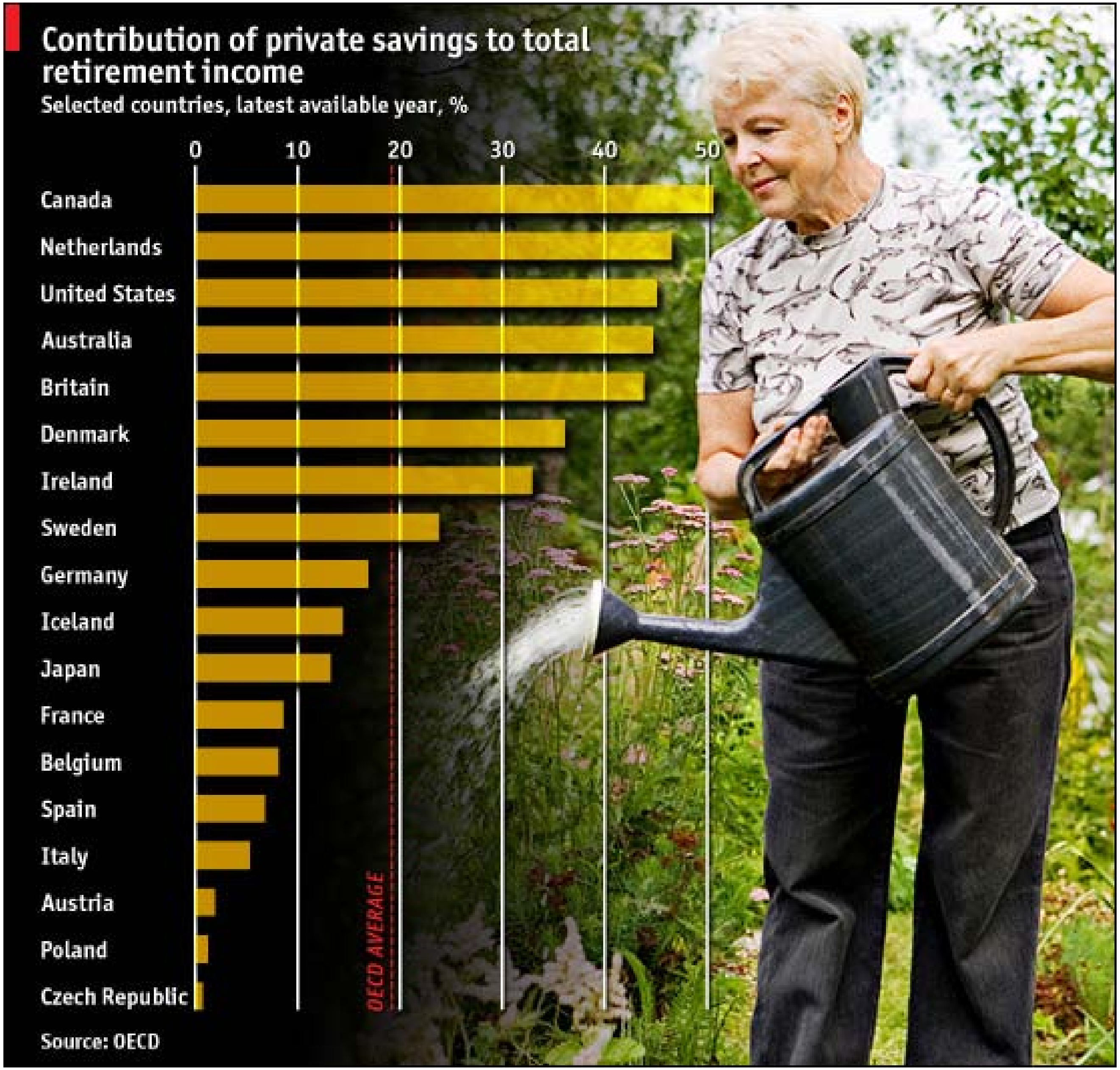

Italy 14.0
Austria 12.6
France 12.4
Greece 11.5
Poland 11.4
Germany 11.4
Portugal 10.2
Belgium 9.0
Japan 8.7
Hungary 8.5
Finland 8.4
Spain 8.1
Turkey 7.8
Sweden 7.7
Czech Republic 7.3
Luxembourg 7.2
Switzerland 6.8
Slovak Republic 6.2
United States 6.0
United Kingdom 5.7
Denmark 5.4
Netherlands 5.0
Norway 4.8
New Zealand 4.4
Canada 4.1
Australia 3.5
Ireland 3.4
Iceland 2.0
Korea 1.6
Mexico 1.3
OECD average:
7.2%
0
2.5
5
7.5
10
12.5
15
Public spending on pensions (% of GDP)

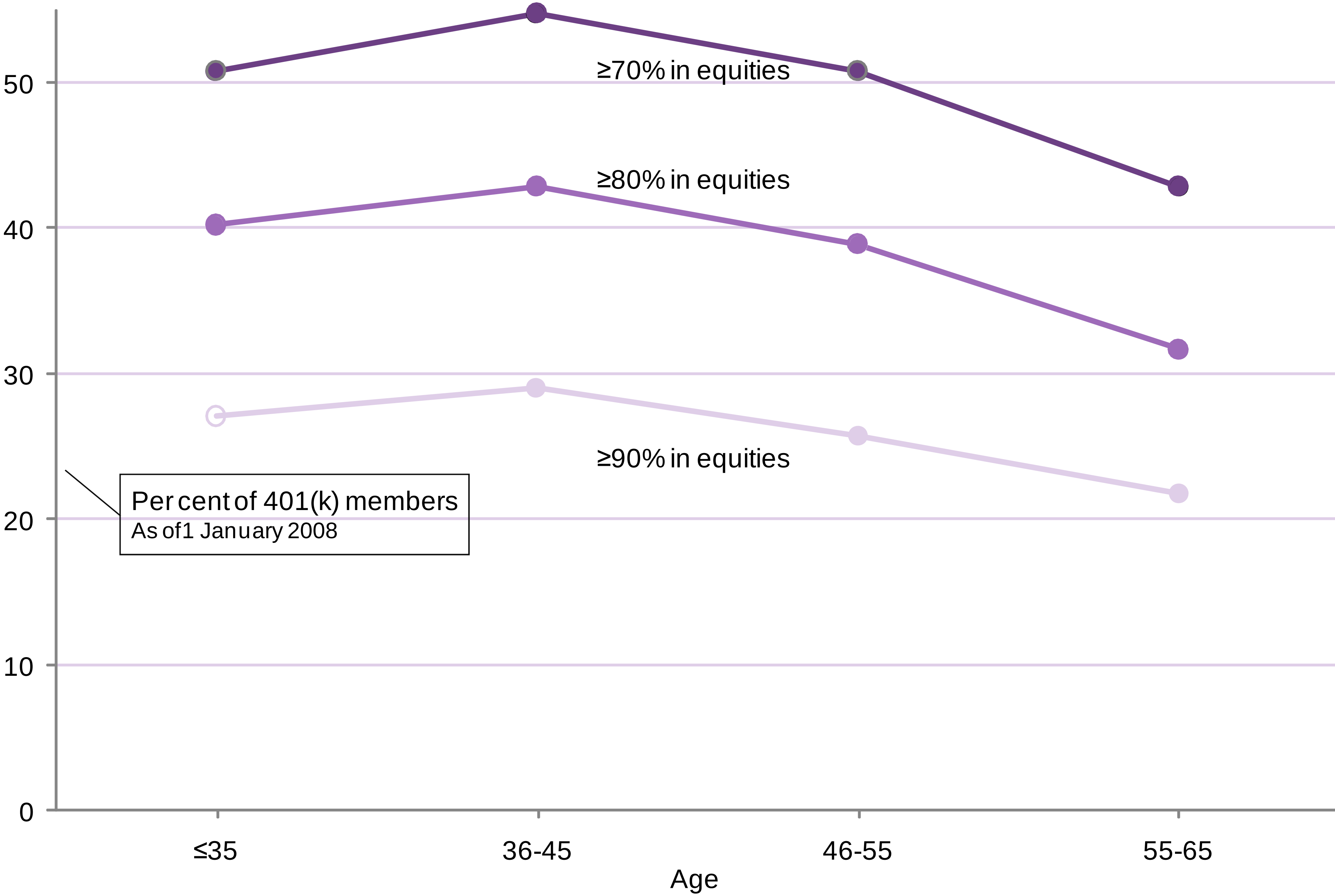
No country, no pension system is immune from the effects of the crisis

Impact is greatest...

- where pensions and other savings are significant
- on workers near retirement
- where people's retirement savings are invested in riskier assets
- where public pension spending was already high
- where old-age safety-nets and automatic stabilisers are weak
- Questions on default, investments and member-engagement


Greece
Iceland
Netherlands
Luxembourg
Turkey
Spain
Denmark
Austria
Hungary
Italy
Sweden
Poland
Norway
Switzerland
Slovak Republic
Finland
Portugal
France
Czech Republic
Canada
Germany
Korea
Belgium
Australia
United States
New Zealand
Mexico
Ireland
Japan
United Kingdom
0
25
50
75
100
Gross pension replacement rate for average earner (%)


Contribution of private savings to total retirement income
Selected countries, latest available year, %
0
10
20
30
40
50
Canada
Netherlands
United States
Australia
Britain
Denmark
Ireland
Sweden
Germany
Iceland
Japan
France
Belgium
Spain
Italy
Austria
Poland
Czech Republic
OECD AVERAGE
Source: OECD



≥70% in equities
≥80% in equities
≥90% in equities
Per cent of 401(k) members
As of 1 January 2008
50
40
30
20
10
0
≤35
36-45
46-55
55-65
Age

Policy responses

What are countries doing?

What are the options and the arguments?

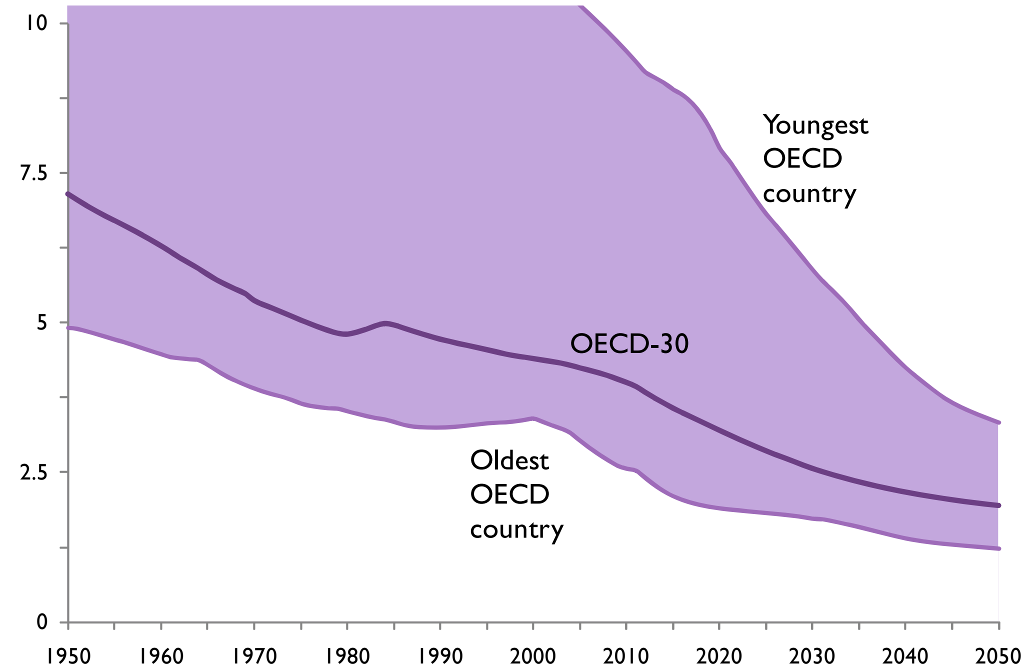
- Stronger safety-nets for old-age incomes
- One-off payments as part of stimulus packages
- Early access to some retirement savings
- Encourage workers to move to less risky assets as retirement nears

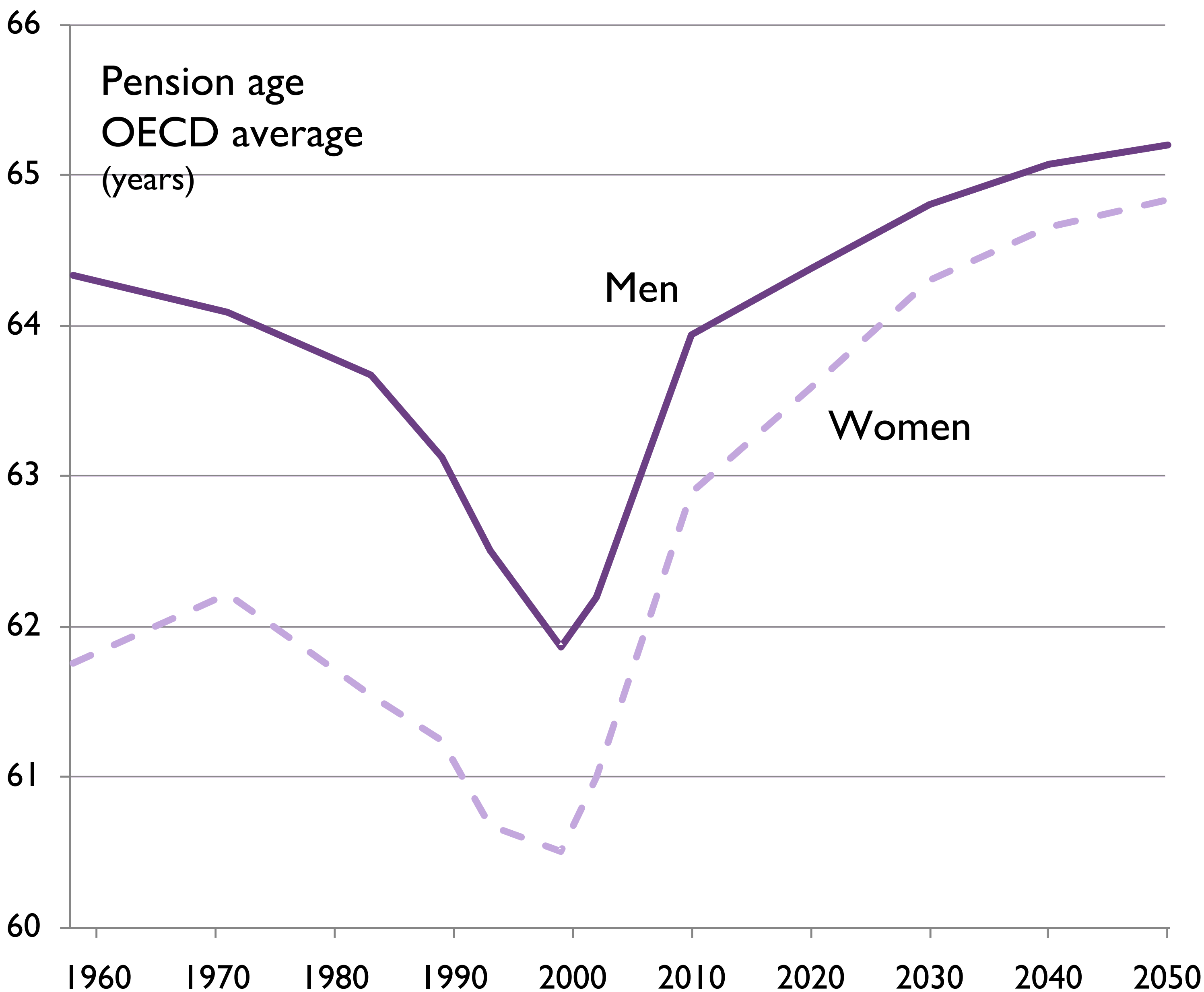
Further challenges:

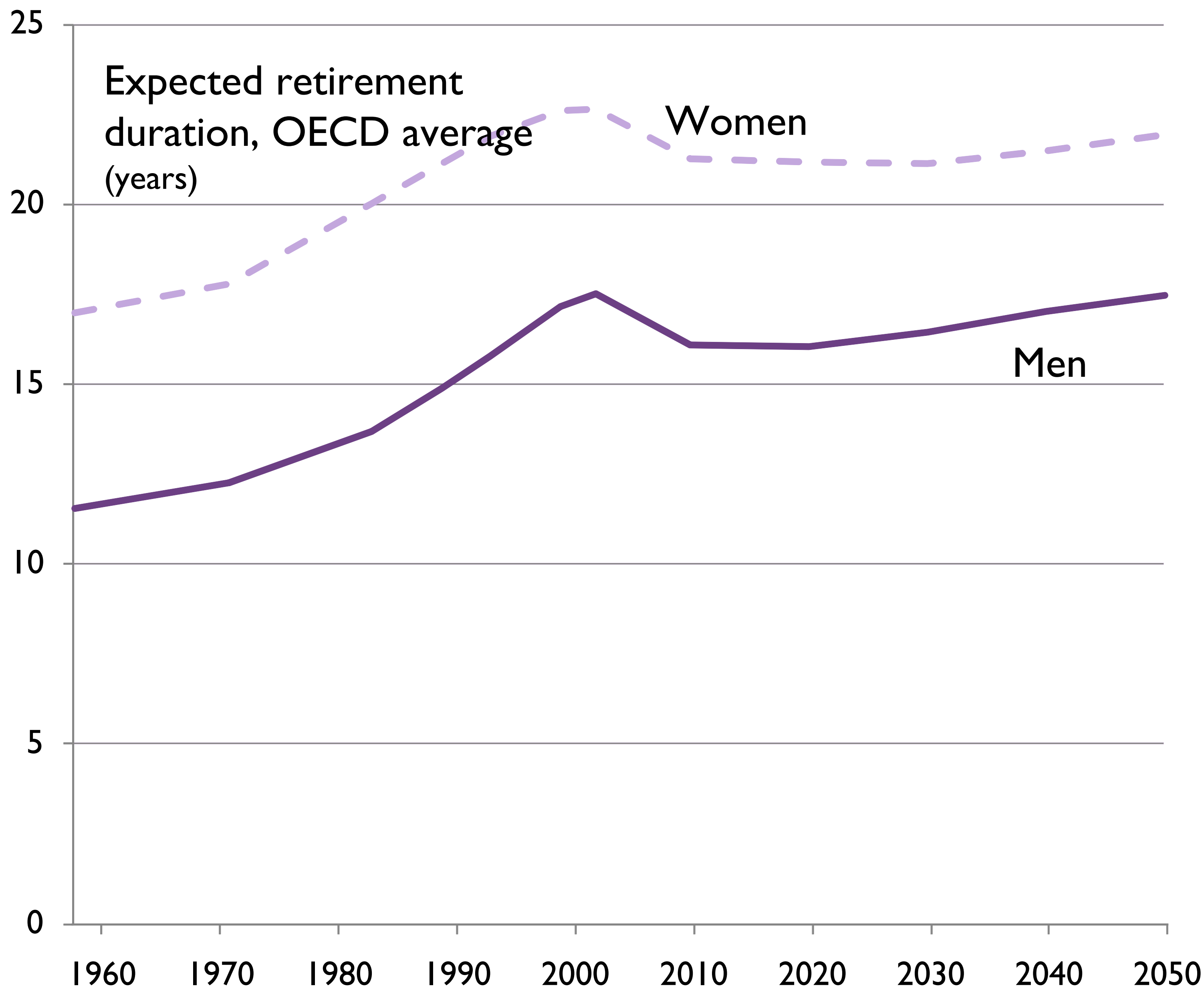
Avoid resorting to early retirement or disability benefits to keep unemployment figures lower.

Long-term problems, such as ageing, have not gone away

Number of people of pension age per person of working age, 1950-2050




Pension age
OECD average
(years)
Men
Women
66
65
64
63
62
61
60
1960
1970
1980
1990
2000
2010
2020
2030
2040
2050



Expected retirement
duration, OECD average
(years)
Women
Men
25
20
15
10
5
0
1960
1970
1980
1990
2000
2010
2020
2030
2040
2050

Policy issues for the UK

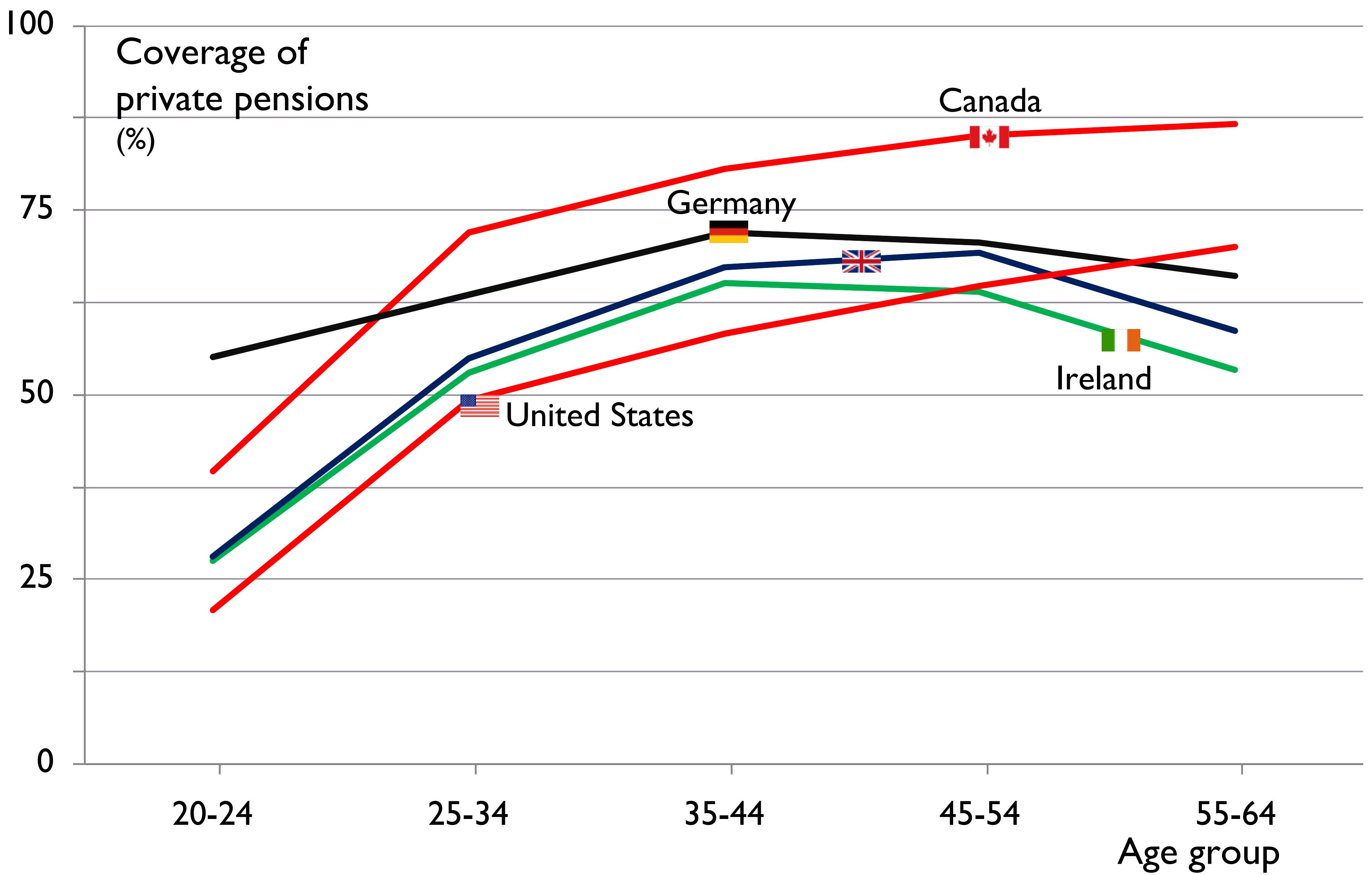
- Will personal accounts increase coverage?
- Recycling and re-using existing pensions infrastructure
- Delivering personal accounts
- Administration capability
- Previous private pension failures
- Pension mis-selling and the related challenges
- Public-sector pensions: time for more reform?

Policy issues for NZ

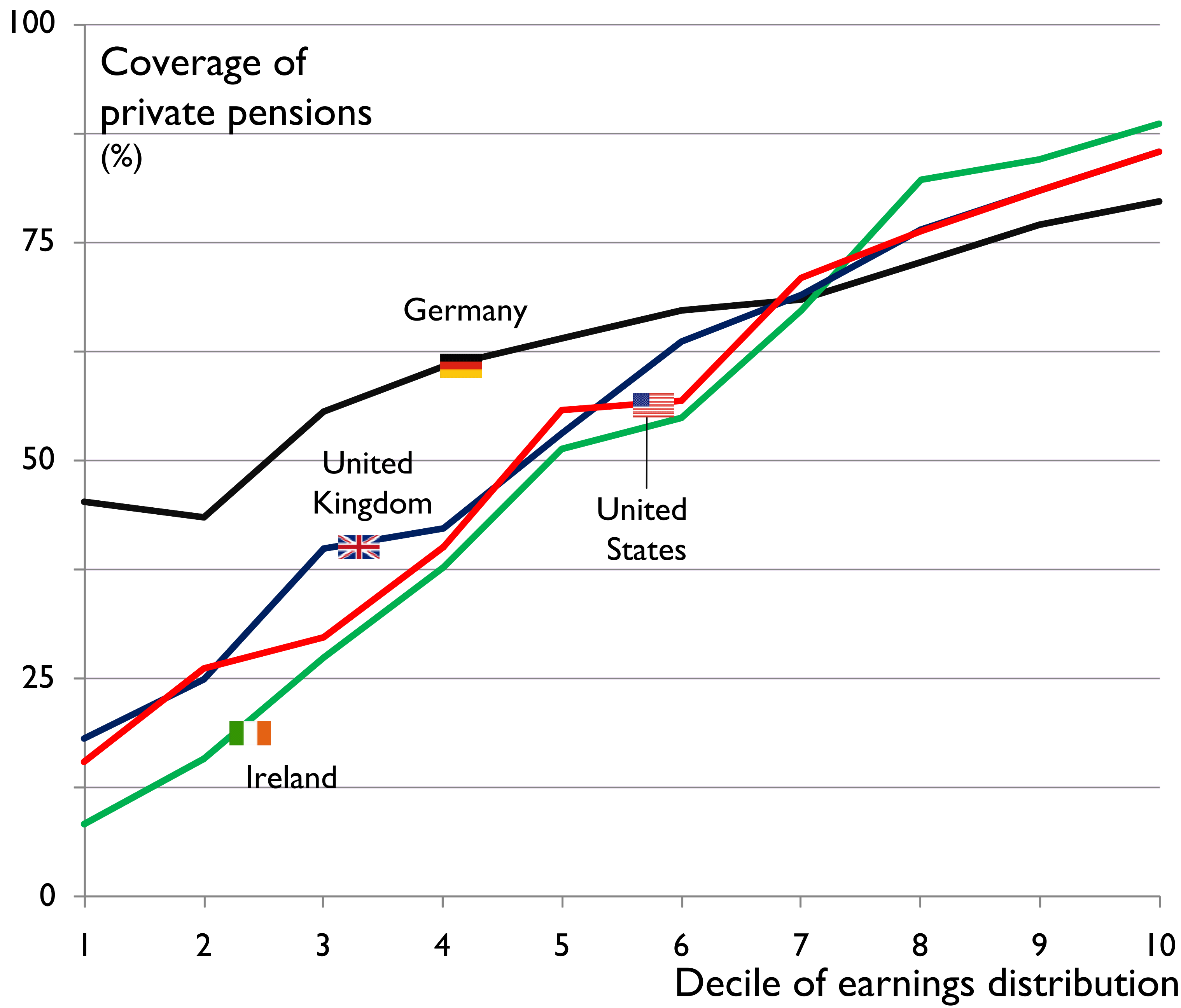
- Low voluntary pension coverage before Kiwisaver -17% coverage
- Automatic enrolment predicated on behavioural finance
- Opt out of the system – Day 16 -54 of starting new employment
- Employer, Employee and Government contributions
- Government co -contribution rejected by new National led government
- New Zealand highly generous first pillar PAYG pensions model

Policy issues for Germany

- Generous first pillar PAYG social security system
- Benefit calculations will see 1st pillar pensions cut for younger worker
- Employer sponsored schemes moving towards full funding from book reserves
- Riester reforms – personal pensions savings continues to be strong
- Strong capital guaranteed products
- Further pension reforms are being evaluated – after national elections



100
75
50
25
0
Coverage of
private pensions
(%)
Canada
Germany
Ireland
United States
20-24
25-34
35-44
45-54
55-64
Age group



100
Coverage of
private pensions
(%)
75
Germany
50
United
Kingdom
United
States
25
Ireland
0
1
2
3
4
5
6
7
8
9
10
Decile of earnings distribution

Key Observations

- Global pension reforms will need to increase in tempo
- Financial and economic considerations are shaping pension reforms
- Tax incentives, soft-compulsion (auto-enrolement) and mandation are being considered by national governments
- Demographics are driving the pace of pension reform
- Default and investment structures will closely mirror plan member behaviours

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